

**Franchise Tax Board****ANALYSIS OF AMENDED BILL**

Author: Yee Analyst: David Scott Bill Number: SB 364  
Related Bills: See Legislative History Telephone: 845-5806 Amended Date: March 21, 2011  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Business Tax Incentive Reporting Information And Penalty

**SUMMARY**

This bill would require taxpayers that claimed a business tax incentive to report certain employment information to the Franchise Tax Board (FTB) and the Board of Equalization (BOE) and would assess a penalty if California employment levels decreased by more than 10 percent.

This analysis will not address the bill's changes to the Sales and Use Tax Law, as they do not impact the department or state income tax revenue.

This is the department's first analysis of this bill.

**RECOMMENDATION AND SUPPORTING ARGUMENTS**

No position.

**Summary of Amendments**

The March 21, 2011, amendments deleted the provisions for business tax incentive recapture and replaced them with a penalty provision. The amendments also changed the annual reporting requirements and add a new reporting requirement for taxpayers to report the employment information to the BOE.

**Summary of Suggested Amendments**

Department staff is available to assist with amendments to resolve the implementation/technical/policy concerns discussed in this analysis.

**PURPOSE OF THE BILL**

According to the author, the purpose of this bill is to bring needed transparency and accountability to tax breaks given to taxpayers under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

Board Position:  
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\_\_\_\_ SA      \_\_\_\_ O      \_\_\_\_ NAR  
\_\_\_\_ N      \_\_\_\_ OUA

Executive Officer	Date
Geoff Way For Selvi Stanislaus	04/04/11

## **EFFECTIVE/OPERATIVE DATE**

This bill would be effective on January 1, 2012, and would apply to taxable years beginning on or after that date. This bill would be specifically operative for business tax incentives added by an act that takes effect on or after January 1, 2012. The bill would be specifically operative for taxable years on or after January 1, 2012, for reporting certain employee information.

## **ANALYSIS**

### **FEDERAL/STATE LAW**

Existing state and federal laws provide various tax incentives (credits, deductions, exemptions, and other tax benefits) designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These tax benefits are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Internal Revenue Code sections 267, 318, and 707 provide rules relating to the current year deductibility of losses, expenses, and interest with respect to transactions between related taxpayers, rules for determining the constructive ownership of stock, and rules governing transactions between partners and partnerships, respectively.

### **Assignment of Credits**

For taxable years beginning on or after June 30, 2008, CTL allows the assignment of certain eligible credits to taxpayers that are members of a combined reporting group. "Assignment" refers to the ability of a taxpayer that is a member of a combined reporting group to elect to transfer certain unused credits to a related corporation, as specified. The election to transfer any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

### **Penalties**

The California Revenue and Taxation Code (R&TC) contains numerous provisions for the assessment of penalties in various situations where taxpayers have failed to comply with the income tax law. Penalties are used to deter certain behavior related to California income tax laws.

### **THIS BILL**

This bill would require a taxpayer doing business in the state that claims a business tax incentive to annually submit certain information to the FTB. The information must be on a timely filed original return and includes the number of full-time, part-time, and temporary employees, as defined, employed by the taxpayer in the state for the current and prior taxable year.

This bill would provide that for any business tax incentive added by an act that takes effect on or after January 1, 2012, if the taxpayer has a decrease in total California employment of more than 10 percent, then for each full-time equivalent employee over 10 percent, the taxpayer would be assessed a penalty of \$5,000. The penalty would be limited to the amount of the business tax incentive the taxpayer claimed on their California income tax return for the prior taxable year. For example, if a taxpayer claimed total business tax incentives of \$3,000 for taxable year 2013, and then, in taxable year 2014, had a decrease in total California employment of one full-time equivalent employee more than 10 percent, then the penalty would be limited to \$3,000—the total amount of the business tax incentive claimed in the taxable year immediately prior to the 2014 taxable year.

The bill defines “Business tax incentive” to mean a credit, deduction, exclusion, exemption, or any other tax benefit provided by the state that is added by an act that takes effect beginning on or after January 1, 2012, enacted with the purpose of creating new jobs in the state, and allowed to taxpayers engaged in or carrying on any trade, business, profession, vocation or calling, or commercial activity in the state.

#### Calculation of Net Decrease in Full-time Employees

The net decrease in qualified full-time employees in the state would be determined annually on a full-time equivalent basis as follows:

- The total number of full-time equivalent employees in the state employed in the preceding taxable year by the taxpayer and by any trade or business acquired by the taxpayer during the current taxable year, minus
- The total number of full-time equivalent employees in the state employed in the current taxable year by the taxpayer and by any trade or business acquired during the current taxable year.

This bill would provide the following definitions:

- “Full-time employee” would mean an employee who works an average of 35 hours in a week, calculated monthly.
- “Part-time employee” would mean an employee who works less than an average of 35 hours in a week, calculated monthly.
- “Qualified wages” would mean wages subject to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.
- “Full-time equivalent” would mean either of the following:
  - In the case of a full-time employee paid hourly qualified wages, the total number of hours worked for the taxpayer by the employee (not to exceed 1,820 hours per employee) divided by 1,820.
  - In the case of a salaried full-time employee, the total number of weeks worked for the taxpayer by the employee divided by 52.

In addition, the bill would provide that all employees of the trades or businesses that are treated as related under either Section 267, 318, or 707 of the Internal Revenue Code would be treated as employed by a single taxpayer.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation considerations. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- The bill is silent as to how to measure changes in employment when one of the two tax periods being compared is a short period of less than a full year. This would make the comparison between taxable years difficult. One method that is possible would be to annualize the short period's employment calculation so that the comparison is on equal terms.
- The bill fails to grant the FTB the authority to prescribe rules or regulations. Without this authority, administration would be difficult because of the possibility of increased disagreements with taxpayers.
- The bill requires that the business tax incentives for which this penalty would be enforced must have the purpose of creating jobs in California; however, this bill's language is silent as to how those administering this bill would know specifically that the tax incentive is for creating jobs. Without specific guidance, there could be disagreements regarding the intent of a bill providing a business tax incentive between taxpayers and the departments administering this penalty.
- The bill language is written in terms of requiring at least one or more employees over the required 10 percent before the penalty could be applied. It appears that if a taxpayer had a decrease of 10 percent plus 3/4 of a full-time employee equivalent, then the penalty would not be assessed. If this is not the author's intent, then an amendment would be needed.
- The bill language is silent regarding penalties relating to pass-through entities, as well as the reporting requirements of any pass-through entities. Those departments administering this bill would need guidance as to which entities would be responsible for reporting the employment information and paying the penalty. Would it be the pass-through entity or the partner/shareholder that would be required to report?
- Members of a combined reporting group can assign credits to other members of the group. Members can leave the group and take the assigned credits with them. The bill is silent as to which taxpayer would report the employee information or which entity would be responsible for the penalty if there was a decrease in California employment that would result in the assessment of the penalty on the credits that were assigned to another entity.
- The bill treats related entities under IRC sections 267, 318, and 707 as a single employer. The bill language is silent as to which member of a related party would be responsible for paying the penalty, if assessed.

- The bill requires the employment information to be provided on a timely filed original return; however, the bill is silent as to what happens if they do not provide the information. Does the penalty get assessed or should there be some other consequence for not providing the information?
- The bill defines a “qualified taxpayer” as engaged in or carrying on a trade or business, profession, vocation, calling or commercial activity in this state, with 101 or more employees. It does not require that the employees be in this state. This lack of clarity could lead to disputes with taxpayers and would complicate the administration of this penalty.
- The bill requires that taxpayers annually include the number of part-time and temporary employees with the employee information reported to the FTB and BOE. However, part-time and temporary employees are not included in the calculation of the decrease in California employment. Only full-time employees are included in the calculation. If that is the author’s intent, the department staff is available to work with the author’s office to resolve this issue.
- The bill states that a qualified taxpayer is a taxpayer engaged in or carrying on a trade, business, profession, vocation, calling, or commercial activity. The bill also states that employees of trades or businesses treated as related under IRC sections 267, 318, or 707, shall be treated as employed by a single qualified employer. The bill leaves out profession, vocation, calling or commercial activity from this paragraph. If it is the author’s intent to include these, an amendment should be added to include these types of activities.
- The bill states that the calculation of the net decrease in full-time employees is computed by subtracting subparagraph (A), full-time employee equivalents in the preceding year, from subparagraph (B), full-time employee equivalents in the current year. Logically, if the calculated number is negative and greater 10 percent of subparagraph (A), there should be a penalty. If the calculated number is positive there should not be a penalty. The language is silent regarding what to do if the calculation produces a negative or positive number. Additionally, the calculated amount should be compared to subparagraph (A), to determine if the decrease is greater than ten percent, but the language is silent on this.

The bill uses the terms “total workforce,” “paid compensation,” and “total value of business incentives” that are undefined. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this penalty.

## **LEGISLATIVE HISTORY**

SBX 6 20 (Yee, 2009/2010) was similar to this bill, except that it provided for the recapture of business tax incentives, rather than impose a penalty. The bill was held in the Senate Rules Committee.

SB 1391 (Yee, 2009/2010) was similar to this bill, except that it provided for the recapture of business tax incentives, rather than impose a penalty. The bill failed to pass out of the Senate Appropriations Committee.

## OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. None of these states have a similar penalty for failing to meet employment requirements for taxpayers taking a business tax incentive.

## FISCAL IMPACT

This bill would require the creation of a new form for reporting the new data. The new data would impact data storage and require additional data being keyed. As a result, this bill would impact the department's printing, processing, and storage costs for tax returns. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would not impact the state's income tax revenue because provisions of the current tax law regarding business tax incentives are unchanged.

This bill would place constraints on potential future changes to tax law. The effects of this bill would be incorporated into the revenue estimates for future proposals to add business tax incentives; however, uncertainty exists as to what those future proposals would be and, therefore, an estimate of the revenue effects is impractical.

## SUPPORT/OPPOSITION

Support: California Labor Federation (co-sponsor)  
State Building and Construction Trades Council of California (co-sponsor)  
California Alliance for Retired Americans  
California Nurses Association  
California Professional Firefighters  
California Tax Reform Association  
California Teamsters Public Affairs Council  
CALPRIG  
San Francisco Child Care Planning, an Advisory Council  
SEIU, Local 1000  
Sierra Club California

Coalition Letter Signed by:  
California Conference Board of Amalgamated Transit Union  
California Conference of Machinists  
Engineers and Scientists of California  
International Longshore & Warehouse Union  
Professional & Technical Engineers, Local 21  
UNITE HERE  
United Food and Commercial Workers Union, Western States Council

Opposition: California Grocers Association

Coalition Letter Signed by:  
BIOCOM  
CalChamber  
California Bankers Association  
California Grocers Association  
California Manufacturers and Technology Association  
CalTax  
CATA  
TechAmerica

## **ARGUMENTS**

Pro: According to the author, this bill would promote greater accountability for keeping jobs in California by taxpayers who have received a tax benefit for creating jobs. In addition, this bill would set clear expectations for corporations and guarantee that the state's investment would yield measurable results in the form of job retention and creation.

Con: Some taxpayers may say that the penalty provision of the bill could unjustly penalize a taxpayer for decreasing the number of California jobs when circumstances for the decrease are beyond the taxpayer's control, such as a severe economic downturn.

## **LEGISLATIVE STAFF CONTACT**

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